INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	6
Conclusion	9

CITATIONS

Cases:

Cammack v. *United States*, 113 F. (2d) 547	8
Fairless v. *Commissioner*, 67 F. (2d) 475	7
Helvering v. *National Grocery Co.*, 304 U. S. 282	6, 7, 9
Perry, J. M., & Co. v. *Commissioner*, 120 F. (2d) 123	8

Statute:

Revenue Act of 1934, c. 277, 48 Stat. 680, 702, Sec. 102 (26 U. S. C., Sec. 102)	2
Revenue Act of 1934, c. 277, 48 Stat. 680, 689, Sec. 23 (k)	7

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 886

UNITED BLOCK COMPANY, INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 15–21) is not reported. The opinion of the Circuit Court of Appeals (R. 120–123) is reported in 123 F. (2d) 704.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 17, 1941 (R. 124). The petition for a writ of certiorari was filed January 19, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether there was evidence to sustain the Board's finding that the taxpayer, a corporation, had been "availed of" for the purpose of preventing the imposition of a surtax on its shareholders, in contravention of Section 102 of the Revenue Act of 1934.

STATUTE INVOLVED

Revenue Act of 1934,[1] c. 277, 48 Stat. 702 (26 U. S. C., sec. 102):

> SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.
>
> (a) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the adjusted net income of every corporation (other than a personal holding company as defined in section 351) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting gains and profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

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[1] The Revenue Act of 1936 applied to taxable years beginning after December 31, 1935. Revenue Act of 1936, Sec. 1, c. 690, 49 Stat. 1648. Thus the petitioner's fiscal year, ending September 30, 1936, was taxable under the Revenue Act of 1934.

(1) 25 per centum of the amount of the adjusted net income not in excess of $100,000, plus

(2) 35 per centum of the amount of the adjusted net income in excess of $100,000.

(b) *Prima Facie Evidence.*—The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to avoid surtax.

* * * * *

STATEMENT

This case raises the question whether, under Section 102 of the Revenue Act of 1934, the petitioner corporation was "availed of" during 1936 for the purpose of preventing the imposition of surtax upon its stockholders by permitting its gains and profits to accumulate instead of distributing them to the stockholders.

Petitioner is a New York corporation engaged in the production and sale of wooden blocks for manufacture into shoe lasts and bowling tenpins. It produces blocks from hard maple found in southern New York and northern Pennsylvania. Production of the blocks requires from eighteen to twenty-four months and a large stock of merchandise (R. 16). In 1936 petitioner's stock was owned by six persons, five of whom were officers

or directors,[2] and the estate of a deceased stockholder (R. 104).

Between 1920 and 1932 petitioner's gross sales ranged from $750,000 to about $1,000,000, and its combined capital and surplus from $750,000 to $1,250,000 (R. 16–17). In 1932 the demand for last blocks fell; petitioner then had a substantial amount of cash no longer required for its business operations. Its officers decided to invest the unneeded funds in securities. They then obtained contracts for tenpin blocks, and that portion of their business rapidly increased (R. 17). For the years 1932–1936, inclusive, petitioner's capital and surplus, gross sales, net income and dividends paid were as follows (R. 17):

Year	Capital and surplus	Gross sales	Net income	Dividends paid
1932	$1,189,524.42	$445,797.09	−$3,454.13	
1933	1,191,130.04	406,383.37	1,605.64	
1934	1,207,526.37	492,703.65	35,043.83	$11,634.00
1935	1,224,798.94	619,240.16	54,526.57	11,004.00
1936	1,329,591.15	784,482.14	115,166.21	10,374.00

Since 1932 petitioner's investments have increased from $41,098 to $230,571 in 1935 and $322,360 in 1936. At the end of the latter year, which is the tax year here in question, petitioner's assets consisted of these securities, $146,848 in cash, notes, and accounts receivable amounting to $454,000, inventories of $364,319, and timber, timber-

[2] 1,326 of the 1,729 shares were owned by these five officials (R. 104).

lands, plant, and equipment valued at $200,320; the total of these assets was $1,487,908. Petitioner's combined capital and surplus in 1936 was greater than in any previous year (R. 17–18). Of petitioner's profit of $124,207 (R. 123),[3] $83,825 resulted from the sale of securities (R. 19).

In 1936 petitioner consulted counsel to see what could be done about collecting or charging off as a bad debt a $150,000 account owed by Daetsch and Woodward, a company in which petitioner owned stock (R. 48, 65, 110–111). He reported that the debtor company would have "to be put through the wringer" (R. 48, 65). In 1936 petitioner's president discussed this matter with agents of the Bureau of Internal Revenue, to whom he stated (R. 48):

> * * * here is a big one we are afraid we are going to lose it all, can we charge a part off this year and the next, and the next?

The agent replied (R. 48):

> No. As long as you are selling them and they pay some interest, they are a going concern, you can't charge it off, because you don't know what the loss is going to be.

Petitioner's president then testified (R. 48): "So we knew it was coming, but we didn't know just

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[3] The Board used the figure $115,166, which represents $124,207 reported income, minus the federal income tax of $9,041 (R. 17, 98).

when." Petitioner charged off the Daetsch and Woodward account during 1937, the year the debtor went into bankruptcy (R. 65–66).

On the basis of these facts the Board of Tax Appeals found that during the fiscal year ending September 30, 1936, petitioner's gains and profits were permitted to accumulate beyond the needs of the business, that this was "*prima facie* evidence of a purpose to avoid surtax, Revenue Act of 1934, Section 102 (b), and has not been overcome" (R. 19–20). In reaching this conclusion the Board took into consideration the amount of existing capital and surplus and its relation to the needs of the business, and also the use of the surplus to purchase industrial securities (R. 20–21). The Board's decision was affirmed by the Circuit Court of Appeals (R. 120–123).

ARGUMENT

The court below stated the question before it to be whether there was substantial evidence to support the Board's finding that the petitioner corporation was "availed of" for the purpose of preventing the imposition of a surtax upon its shareholders (R. 120). After a painstaking review of the evidence, the court concluded that there was (R. 122). If so, the finding of the Board is conclusive. *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 294.

The taxpayer seeks to avoid the consequences of this finding on the ground (Pet. 9) that the

tax was only ostensibly imposed on its income for that year, that it was in fact imposed upon its surplus of gains and profits for prior years. This contention is predicated on the assumption that during 1936, the tax year, a $150,000 loss on the Daetsch and Woodward account nullified the net reported income of $124,207 (Pet. Br., p. 9). But the debt was concededly not charged off until the tax year 1937 [4] (R. 65–66), and thus cannot be deducted as a bad debt in 1936. Revenue Act of 1934, Sec. 23 (k), c. 277, 48 Stat. 689; *Fairless* v. *Commissioner,* 67 F. (2d) 475, 477 (C. C. A. 6th), and cases cited.

It was, of course, entirely proper for the Board to take into consideration prior accumulations in considering whether an accumulation during a particular year is "beyond the reasonable needs of the business." The greater the prior accumulation in relation to capital and surplus, liquid assets and sales, the less necessary is it for the business to accumulate further. This was recognized in the *National Grocery* case, where the Court explicitly took into account the amount accumulated at the beginning of the taxable year (304 U. S., at 291–294).

Petitioner lays great stress upon allegedly erroneous advice given by officials of the Bureau of

[4] In 1937 petitioner's income, apart from the above debt, was $158,000 (R. 99), so that there was ample opportunity to take advantage of the $150,000 loss during that tax year. Cf. R. 123.

Internal Revenue that the above loss could not be charged as a bad debt in 1936. In view of the clear language of Section 23, this would have been immaterial. Moreover, it appears from petitioner's testimony that at that time petitioner did not "know just when" the loss was coming; and the question asked revenue agents was, "Can we charge a part off this year and the next, and the next?" (R. 48). The reply that this could not be done was plainly correct. See, p. 5, *supra*. In view of the nature of the informal inquiry, petitioner cannot attribute its failure to charge the debt off in 1936 to erroneous advice by Bureau officials, irrespective of any undisclosed facts which its attorney's investigation may have revealed.

Cammack v. *United States,* 113 F. (2d) 547 (C. C. A. 8th), which petitioner claims to be in conflict, did not arise under or involve in any way the statute taxing unreasonable corporate accumulations. The court there held merely that a taxpayer who did not keep formal books could deduct a bad debt without a written "charge-off," particularly when his failure to make any written notation was attributable to statements made by Internal Revenue agents.

J. M. Perry & Co. v. *Commissioner,* 120 F. (2d) 123 (C. C. A. 9th), which petitioner also claims to be in conflict with the decision below, did involve the tax on unreasonable corporate accumu-

lations. In that case, on facts entirely different from those at bar, the application of the tax was upheld. There plainly is no conflict.

Petitioner claims that this case is important because it is the first reported decision in which this tax has been imposed upon a manufacturing corporation. But under the tax a manufacturer is in no different position from a grocery concern. Cf. *Helvering* v. *National Grocery Co., supra.*

CONCLUSION

This case presents no question of importance, but merely a factual application of the rule laid down in *Helvering* v. *National Grocery Co.,* 304 U. S. 282. There is no conflict of decisions. Accordingly, the petition for certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
J. LOUIS MONARCH,
CARLTON FOX,
ROBERT L. STERN,
Special Assistants to the Attorney General.

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